



CITY OF SCOTTS VALLEY

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TREASURER
STATE OF CALIFORNIA

OFFICE OF THE CITY MANAGER

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May 8, 2008

Ms. Gail Sussman
Group Managing Director
Public Finance
Moody's Investor Service
250 Greenwich Street
New York, NY 10007

Mr. William Montrone
Head
U.S. Public Finance Dept
Standard & Poor's
55 Water Street
New York, NY 10041

Mr. Robert Grossman
Group Managing Director
U.S. Public Finance
Fitch Ratings
33 Whitehall St., 27th Fl.
New York, NY 10004

SUBJECT: Ending Double Standard in Ratings of Municipal and Corporate Bonds

Dear Ms. Sussman, Mr. Montrone and Mr. Grossman:

The current system of assigning credit ratings to bonds issued by governmental entities which provide essential services to the public leads to indefensible market discrimination against state and local municipal issuers. The ratings agencies' own studies show that the likelihood of default by municipal borrowers is much lower than for corporate borrowers with similar ratings. Ratings should be based primarily on an evaluation of the likelihood investors will suffer a loss due to default. Unfortunately, for municipal bonds, they are not. This practice costs taxpayers enormous amounts of money that could be invested in public programs and infrastructure.

The City Council of the City of Scotts Valley adopted a resolution on May 7, 2008, (copy enclosed), urging your companies to end the double standard in the treatment of municipal and corporate bonds based on the risk of investor loss due to default. Finally, we urge you to do this by creating a unified global rating approach that treats all issuers equally, thereby serving taxpayers and investors.

Sincerely,

Charles A. Comstock
City Manager

Attachment: Resolution No. 1813

c: California State Treasurer Bill Lockyer

RESOLUTION NO. 1813

RESOLUTION OF THE CITY COUNCIL OF THE CITY OF SCOTTS VALLEY SUPPORTING REFORM OF THE BOND RATING SYSTEM TO ELIMINATE DISCRIMINATION AGAINST MUNICIPAL BONDS

WHEREAS, the recent turmoil in the municipal bond markets has brought into focus the higher standards imposed by the three major bond rating agencies in rating municipal bonds compared to corporate bonds, mortgage-backed securities and other debt instruments; and

WHEREAS, issuers of municipal bonds rarely default on the bonds they sell to finance streets and roads, public buildings, bridges, flood protection and water systems, and other critical infrastructure, yet municipal bond ratings fail to reflect that fundamental fact; and

WHEREAS, the rating agencies even acknowledge this disparity, but they ignore it in their ratings. Standard & Poor's, for example, acknowledges that the historic rate of defaults of A-rated municipal bonds is 0.23 percent, while that of corporate bonds is 2.91 percent; and

WHEREAS, despite the relative default rates shown by their own data, the rating agencies continue to discriminate against municipal issuers, requiring public agencies to secure expensive bond insurance in order to secure bond ratings comparable to those of private corporations; and

WHEREAS, the rating agencies base their ratings of corporate bonds on the risk the issuer will default. Their ratings of municipal bonds, in contrast, have little relationship to the risk of default. This difference provides a substantial economic benefit at the expense of taxpayers across the nation; and

WHEREAS, a coalition of state and local agencies, led by California State Treasurer Bill Lockyer, has called on the three major rating agencies to examine their practices and treat municipal bonds on par with corporate bonds that expose investors to the same level of risk. The Treasurer also testified before the House Financial Services Committee on March 12, 2008, about the need for reform; and

WHEREAS, the response by the rating agencies to the call for reform has been uneven. Moody's has taken the greatest strides, announcing it will assign a corporate-equivalency rating (what it calls a global scale rating or GSR) alongside the traditional municipal rating to any municipal bond at the issuer's request; and

WHEREAS, the current double-standard by rating agencies: (1) drains billions of dollars from taxpayers' pockets in the form of unfairly high interest rates; (2) forces taxpayers' to pay even more money to buy bond insurance - insurance they would not have to purchase if municipal bond ratings accurately reflected the slight risk of default; (3) misleads investors by grossly inflating the risk of buying municipal bonds, and (4) undermines the effective functioning of a transplant market.

NOW, THEREFORE, BE IT RESOLVED, by the City Council of the City of Scotts Valley that it calls on the major municipal bond agencies to end the double standard in the treatment of municipal and corporate bonds; to treat taxpayers the same as corporations and rate municipal bonds based on the risk of default; and to create a unified, global rating approach that treats all issuers equally, and better serves taxpayers and investors; and

BE IT FURTHER RESOLVED, that the City Manager is hereby directed to notify the municipal bond rating agencies by letter of the adoption of this resolution, with a copy to California State Treasurer Bill Lockyer and to register the City as a member of the coalition of public agencies supporting the nationwide effort to reform how bond rating agencies grade state and local bonds.

This Resolution was passed and adopted by the City Council of the City of Scotts Valley at a regularly scheduled meeting on the 7th day of May, 2008 by the following vote:


AYES: AGUILAR, BARRETT, BUSTICHI, REED, JOHNSON

NOES: NONE

ABSENT: NONE

ABSTAIN: NONE

Approved: _____


Randy Johnson, Mayor

Attest: _____


Tracy A. Ferrara, City Clerk